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United States General Accounting Office

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Report to the Honorable
William Proxmire, U.S. Senate

COMPLETED

February 1987

DOD INFLATION

Updated Estimates of DOD's Fuel Inflation Dividends

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ORIGINAL

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United States
General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

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February 23, 1987

The Honorable William Proxmire
United States Senate

Dear Senator Proxmire:

On September 5, 1986, we responded to your request for an updated estimate of inflation dividends within the Department of Defense (DOD) budget. At that time, we did not include a fuel inflation dividend. This report provides estimates of DOD's fuel inflation dividends for fiscal years 1986 and 1987.

In July 1986, the Office of Management and Budget (OMB) issued preliminary projections of changes in fuel prices, indicating that fiscal year 1986 fuel prices would probably decline by 29.4 percent from the actual fuel prices in fiscal year 1985 and decline an additional 20 percent in fiscal year 1987. In July 1986, DOD used these percentage changes in fuel prices to calculate potential fuel inflation dividends for fiscal years 1986 and 1987. When making these calculations, DOD also included changes in the mix of petroleum products to be procured. Based upon these assumptions, DOD's inflation dividend estimate for fiscal years 1986 and 1987 was $3.10 billion. This amount was included in DOD's July inflation report, which was submitted to the Congress.

Using the fuel price estimates contained in OMB's August 1986 Mid-Session Review of the 1987 Budget, we calculated the DOD fuel inflation dividends in the President's February 1986 budget submission. In August 1986, OMB's fuel price projections for fiscal year 1986 indicated that fuel prices would probably decline by 33.3 percent from the actual fuel prices in fiscal year 1985. OMB also projected that fuel prices in fiscal year 1987 would probably decline an additional 24 percent from the fiscal year 1986 prices. Using these percentage changes in fuel prices, we computed a potential fuel inflation dividend of $4.61 billion for fiscal years 1986 and 1987.[1]

The Congress reduced the DOD budgets for fiscal years 1986 and 1987 fuel procurements by $3.46 billion. The total inflation reduction made to the fuel budget requests for fiscal years 1982 through 1987 was $7.45 billion. Using OMB's August 1986 fuel price projections and actual

[1]OMB's January 1987 projections would produce a slightly smaller fuel inflation dividend for fiscal year 1987.

refiners' acquisition cost, we calculated the total amount of fuel inflation dividends for fiscal years 1982 through 1987 to be $8.94 billion. The amount of reductions taken by the Congress is 83 percent of the total of potential dividends when dividends are calculated in this way. However, this fuel dividend calculation is based on an approximation of changes in actual and projected refiners' acquisition cost of crude oil, not on actual and projected prices of the fuel products DOD buys.

DOD's calculations of actual dividends for prior years are the differences between what was appropriated for fuel and the actual costs DOD incurred for its fuel purchases such as aviation fuel, diesel fuel, heating oil, kerosene, and gasoline. DOD calculated dividends based on actual costs for fiscal years 1982 through 1985, and in July 1986 estimated fuel inflation dividends for fiscal years 1986 and 1987. DOD's estimation of the actual and projected fuel inflation dividends for fiscal years 1982 through 1987 is $7.68 billion. The total inflation reduction of $7.45 billion, which the Congress made to the fuel budget requests for fiscal years 1982 through 1987, is 97 percent of the amount that DOD estimated for fuel inflation dividends.

We discussed a draft of this report with the Director, Plans and Systems, and budget analysts in the Office of the Deputy Assistant Secretary of Defense (Program/Budget), Assistant Secretary of Defense (Comptroller). These officials, who are responsible for inflation adjustments, agreed with this report. We did not request DOD comments on the report. Our work was conducted using generally accepted government auditing standards.

The appendix provides additional detail regarding DOD's fuel inflation dividends.

Copies of this report are being sent to the Chairmen, House and Senate Committees on Appropriations, Senate Committee on Governmental Affairs, and House Committee on Government Operations. Copies are also being sent to other interested parties and will be provided to others upon request.

Sincerely yours,

Frank C. Conahan
Assistant Comptroller General

Fuel Inflation Dividends in the DOD Budgets

In the DOD budget request submitted to the Congress, DOD uses OMB's estimates of refiners' acquisition cost (RAC) for the current year and the budget year. As time passes, more up-to-date information is obtained on actual and projected fuel prices.

We calculated the fuel inflation dividend for fiscal years 1986 and 1987 by comparing the projections of RAC used in preparing the budgets for fiscal years 1986 and 1987 and the August projections of RAC that OMB used for the Mid-Session Review of the 1987 Budget. With one exception, the dividends for fiscal years 1982 through 1985 are those previously cited in our May 1986 report, Budgeting for Inflation in DOD Purchases of Petroleum Products, GAO/NSIAD-86-125, which discussed estimates of these dividends. In commenting on that report, the Assistant Secretary of Defense (Comptroller) noted a mistake in inflation rates on page 7 of the report. We have made that correction and recomputed the fiscal year 1984 estimate, which decreased from $1.64 billion to $1.24 billion. Table I.1 reflects that change. The total fuel inflation dividend for fiscal years 1982 through 1985 is $4.33 billion, rather than the $4.73 billion estimate in our prior report. Table I.1 shows our estimate of DOD's fuel inflation dividends for fiscal years 1982 through 1987.

Table I.1: DOD's Estimated Fuel Inflation Dividends Based on Our May 1986 Report and OMB's August 1986 RAC Projections

Dollars in billions

Fiscal year 1982	Fiscal year 1983	Fiscal year 1984	Fiscal year 1985	Fiscal year 1986	Fiscal year 1987	Total
$1.07	$1.27	$1.24	$0.75	$1.99	$2.63	**$8.94**

According to information provided by the Assistant Secretary of Defense (Comptroller), DOD's actual total dividend, resulting from lower than anticipated fuel prices for fiscal years 1982 through 1985, was $4.58 billion. DOD's projected fuel inflation dividend for fiscal years 1986 and 1987, calculated in July 1986, was $3.10 billion. DOD's amounts differ from our amounts because in its July estimate, DOD used OMB's July 1986 projections while we used OMB's August 1986 projections. Also, DOD made adjustments to reflect changes in the mix of products to be procured by the services, which affects the total costs and therefore the potential dividends. The total fuel inflation dividend identified by DOD for fiscal years 1982 through 1987 is $7.68 billion, as shown in table I.2.

Table I.2: DOD's Actual and Projected Fuel Inflation Dividends

Dollars in billions

	Fiscal year 1982	Fiscal year 1983	Fiscal year 1984	Fiscal year 1985	Fiscal year 1986	Fiscal year 1987	Total
DOD's actual fuel cost calculations	$1.80	$1.40	$0.61	$0.57			**$4.58**
DOD's July projections					$1.29[a]	$1.81	**$3.10**
Total dividends							**$7.68**

[a]Based on our preliminary analysis of data provided by the Defense Logistics Agency, the actual dividend for fiscal year 1986 is close to DOD's July projections for that year

According to officials in the DOD Comptroller's office, congressionally directed fuel budget reductions have been made based upon changes in the projections of fuel prices. After the fiscal year 1984 budget had been submitted to the Congress, DOD provided the Congress with a revision that reduced the amount requested by $1.33 billion. With this adjustment, the fuel inflation reductions to the DOD budgets from 1982 through 1987 total $7.45 billion, as shown in table I.3.

Table I.3: DOD's Fuel Budget Inflation Reductions (Made to the Operations and Maintenance and the Research, Development, Test and Evaluation Budgets)

Dollars in billions

	Fiscal year 1982	Fiscal year 1983	Fiscal year 1984	Fiscal year 1985	Fiscal year 1986	Fiscal year 1987	Total
Congressionally directed	$0.50	$0.85		$1.31	$0.44	$3.02	**$6.12**
DOD revision to budget submission			$1.33				**$1.33**
Total reduction							**$7.45**

The total inflation reduction that the Congress has made to the fuel accounts, as shown in table I.3, is $7.45 billion. This amount is 83 percent of the $8.94 billion we identified based on OMB's August 1986 RAC projections. However, the changes in RAC projections do not necessarily mean that any additional inflation dividend is available because these projections are subject to further change. In addition, changes in RAC may differ from changes in actual product prices, as discussed in our May 1986 report. DOD's actual and projected fuel inflation dividend for fiscal years 1982 through 1987 is $7.68 billion. The total inflation reduction made by the Congress between 1982 and 1987 is 97 percent of the inflation dividend amounts that DOD identified.

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